

SECTION III

CURRENT ENVIRONMENT

INTRODUCTION TO THE CURRENT ENVIRONMENT

Purpose The Current Environment section reports on the progress to date in achieving the Department's financial management goals, discusses current DoD roles and responsibilities, and the financial management structure. This section also notes the present financial management status and identifies areas requiring improvement. Finally, the section provides an assessment of the Department's current financial management status and identifies how the Department will move from its current environment to the target architecture of an integrated financial management system as laid out by the Concept of Operations (Concept).

Scope The Department is focusing attention on bringing its finance, accounting and critical feeder systems into substantial compliance with applicable federal requirements. The Department has tasked the Military Departments and the Defense Agencies to evaluate the compliance status of their respective systems by March 31, 2000.

The Department is taking a two-track approach toward reaching an integrated financial management system and achieving auditable financial statements. Both short-term and long-term strategies have been developed to move the Department from the current environment to its target architecture. Ultimately, the Department intends to achieve sound financial management through financial management reform.

ACHIEVEMENTS AND PROGRESS TO DATE

DoD Goals The FY1998 Plan identified three long-term financial management goals to serve as tools in setting priorities and measuring programmatic success. These goals seek to ensure that financial management better fulfills the needs of its leaders, meets statutory requirements, maximizes efficiency, minimizes opportunities for fraud, and provides outstanding customer service. These three goals are to:

- implement effective systems
- reengineer DoD business practices
- improve the financial management framework

The Department's goals are tied directly to reaching the target architecture outlined in the Concept. Implementing effective systems relates to achieving substantially compliant finance, accounting, and critical feeder systems. Reengineering DoD business practices relates to providing updated policy and oversight guidance that leads to effective and efficient financial management processes. Improving the financial management framework entails the supporting infrastructure initiatives that provide the environment in which financial management operates.

DoD Achievements The Department has continued to make progress toward achieving an integrated financial management system by pursuing the goals listed above. Achievements and progress this year toward those goals are described below.

Implement Effective Systems The Department's approach for improving financial management is to move toward the target architecture of an integrated financial management system in which financial management functions will operate. As stated in the Concept, the Department's integrated financial management system will be comprised primarily of substantially compliant finance, accounting, and critical feeder systems of the Military Departments and Defense Agencies.

In FY 1998, for the first time, the Department identified critical feeder systems in its official inventory. This year, 70 feeder systems were identified as critical. The core finance and accounting systems rely heavily on these critical feeder systems for financial management data. The Department's inventory of critical finance, accounting, and feeder systems is located in Appendix B of this volume.

In March 1999, a memorandum signed by the Principle Deputy Under Secretary of Defense (Comptroller) directed owners of finance and accounting systems and critical feeder systems to evaluate their systems for compliance status by March 31, 2000. Where systems are noncompliant, deficiencies must be identified and action plans for resolving them created. The memorandum also requires that, after systems have been evaluated, Memorandums of Agreement (MOAs) be established between the DFAS and critical feeder systems owners. These MOAs will provide an overall coordination mechanism to correct deficiencies and internal control weaknesses, and fully integrate all finance, accounting, and critical feeder systems.

The strategy for implementing effective finance and accounting systems to achieve the target of an integrated financial management system also includes eliminating unnecessary systems and consolidating finance and accounting systems to a select set of migration systems. System consolidation efforts are generally complete for the finance functions, and the accounting systems consolidations are still underway. As of September 1999, there are 98 finance and accounting systems (15 finance systems and 83 accounting systems).

The objective of the Department's consolidation of systems, however, is not simply to reduce the number of financial management systems. The consolidation, standardization, and modernization of the Department's financial management systems is meant to enable the Department to eliminate its outdated noncompliant financial management systems and replace them with financial management systems that provide more accurate, timely, and meaningful financial management information for decision-makers.

Reengineer
DoD Business
Practices

A critical aspect of the Department's financial management reform is the reengineering of its business practices, which are the procedures by which management and administrative systems function. The goal is to make DoD business practices simpler, more efficient and less prone to error. This goal is comprised of policy and oversight strategies.

A management oversight structure was constructed to ensure the involvement of the Department's senior leaders in the financial improvement process. This structure includes a DoD Financial Management Steering Committee and a Working Capital Funds Policy Board. These entities actively engage in approving and monitoring the Department's financial management reform.

The Department took steps to reduce the volume of financial management regulations by publishing the DoD FMR. The DoD FMR replaces approximately 70,000 pages of separate DoD regulations by consolidating and standardizing DoD policy and procedures and eliminating duplicate, obsolete policy and directives. All 15 volumes of the DoD FMR are available on the Internet. Paper copies are no longer automatically issued, however, paper and

CD-ROM copies of the volumes can be ordered through the DoD FMR site on the Internet.

The Department is using competition both within the government and the private sector to improve its financial services. Changes implemented by the DFAS, as a result of competition studies, have produced annual savings of \$23 million through streamlining of administration operations, facilities, logistics, and the consolidation of debt and claims management, and vendor payments. Other reforms to the contractor payment and audit process have helped increase the accuracy rate of payments, expedited the settlement of overhead rates and the closeout of contracts, and are playing an instrumental role in the initiative to improve the procurement process, with the goal of becoming paperless early in the next century.

The Department is also using public-private competition (the A-76 process) to improve functions and reduce costs. Within the financial community, there are on-going A-76 studies in several critical areas, such as depot maintenance accounting, civilian payroll, and retiree/annuitant payroll. Approximately one-third of the DFAS operations, measured in terms of costs, have been either outsourced, competed for outsourcing, or are in the process of an outsourcing competition.

Improve
Financial
Management
Framework

The Department has reorganized the way it operates its finance and accounting. In 1991, the DFAS was established to reduce the cost and improve the overall quality of DoD financial management through consolidation, standardization, and integration of finance and accounting procedures, operations, and systems.

The finance and accounting functions were divided between the DFAS and the Military Departments and the Defense Agencies. The DFAS processes transactions and prepares the financial statements. The Military Departments and the Defense Agencies retained certain primary level, programmatic finance and accounting functions, as they are best performed at the installation and agency level.

ROLES AND RESPONSIBILITIES

Purpose Over the past several years, the Department's finance and accounting organization and management structure underwent major changes. Significantly, the DFAS, the Military Departments, and the Defense Agencies now share the finance and accounting responsibilities that previously belonged only to the Military Departments and the Defense Agencies.

Organization and Management As illustrated in Figure III.1, two chains of command within the Department perform finance and accounting operations. On one side is the DFAS, which reports to the Under Secretary of Defense (Comptroller) (USD(C)) within the Office of the Secretary of Defense. On the other side are the Military Departments, headed by their respective Secretary, and the Defense Agencies, led by their respective Director. Each Military Department Secretary has an Assistant Secretary (Financial Management and Comptroller) who directs and manages financial management activities consistent with policies prescribed by the USD(C) and the Military Department's implementing directives. Each Defense Agency has a Comptroller whose responsibilities are similar.

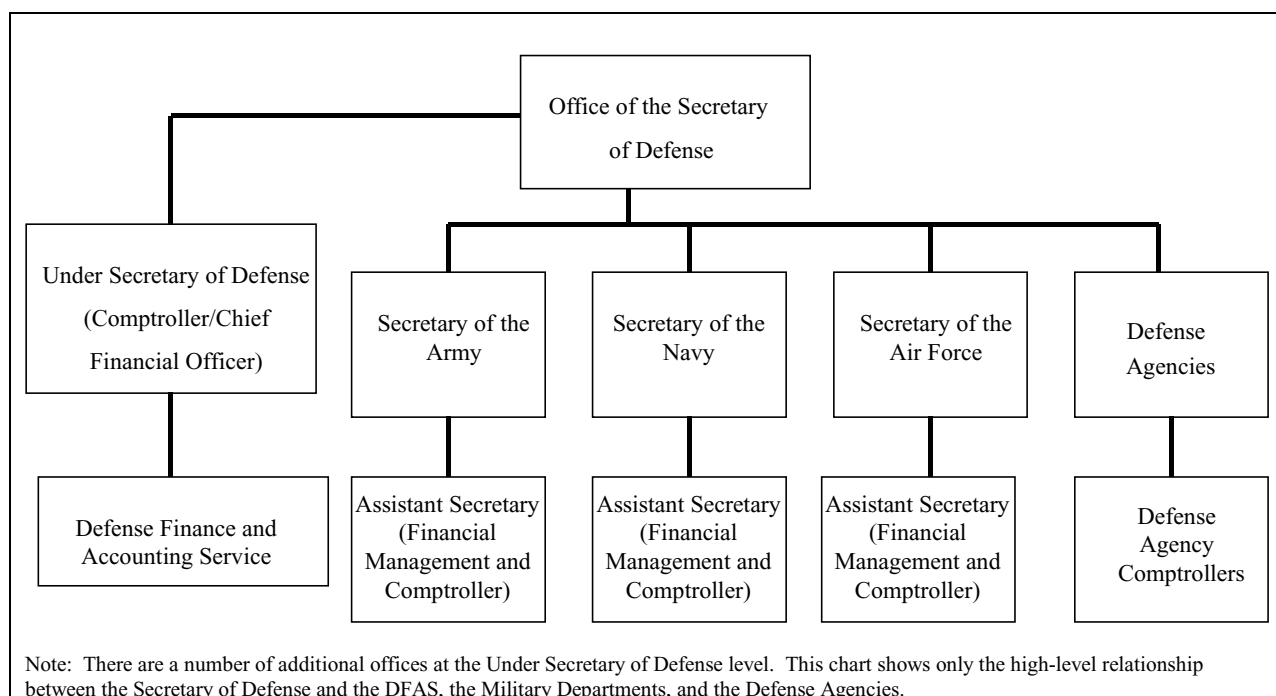


Figure III.1 Relationship between the Secretary of Defense and the DFAS, the Military Departments, and the Defense Agencies

**Under
Secretary of
Defense
(Comptroller)**

The USD(C) is the principal advisor and assistant to the Secretary and Deputy Secretary of Defense for budgetary and fiscal matters (including financial management, accounting policy and systems, budget formulation and execution, and contract audit administration and organization), DoD program analysis and evaluation, and general management improvement programs.

The National Defense Authorization Act for Fiscal Year 1994 designated the USD(C) as the Department's CFO0. Specific duties of the USD(C)/CFO as specified in the Chief Financial Officers Act include:

- interpreting, augmenting and promulgating financial management laws, regulation, and guidance within the Department
- directing, managing, and providing policy guidance and oversight of agency financial management personnel, activities, and operations
- developing and maintaining integrated financial and accounting management systems
- monitoring the financial execution of the agency budgets in relation to actual expenditures, and preparing and submitting timely performance reports
- overseeing the recruitment, selection, and training of personnel to carry out agency financial management functions

The USD(C) has no direct line of authority over any of the financial management staff within the Military Departments, the Defense Agencies, or DoD field activities. They report through their own organizational structure to their respective unit heads. The USD(C) and the unit heads report to the Secretary of Defense. The USD(C), however, does issue policies, instructions, regulations, and procedures relating to financial management matters and the production of financial statements, which are binding on all DoD activities.

DFAS

The DFAS is responsible for identifying and implementing finance and accounting requirements, systems, and functions for appropriated and non-appropriated funds, as well as working capital funds, revolving funds, and trust fund activities, including security assistance.

In December 1992, the DFAS assumed responsibility for all finance and accounting operations and the associated 332 installation finance and accounting offices and began to consolidate. Today the DFAS consists of a Headquarters located in Arlington, Virginia, with five centers located in Cleveland, Ohio; Columbus, Ohio; Denver, Colorado; Indianapolis, Indiana; and Kansas City, Missouri; and 19 OPLOCs.

**Military
Departments
and the
Defense
Agencies**

Each Military Department has an Assistant Secretary for Financial Management and Comptroller who reports to the Military Department Secretary and directs and manages financial management activities consistent with policies prescribed by the USD(C)/CFO and the Military Department's implementing directives. The Assistant Secretary for Financial Management and Comptroller position in each Military Department was established in the National Defense Authorization Act for Fiscal Year 1989. This act delineated many of the responsibilities of the office, including:

- managing financial management activities and operations
- directing the preparation of budget estimates
- approving any asset management systems, including cash and credit management
- collecting debts
- accounting for property and inventory systems

Each Defense Agency has a comptroller who directs and manages financial management activities consistent with policies prescribed by the USD(C)/CFO.

Financial management functions are divided between the Military Departments and the Defense Agencies and the DFAS. The division results in certain primary-level, programmatic financial functions remaining with the Military Departments and the Defense Agencies.

**DoD
Management
Oversight
Structure**

The Department is using a management oversight structure to ensure the involvement of the Department's senior leaders in the financial improvement process. This includes the DoD Financial Management Steering Committee and the Working Capital Funds Policy Board (Policy Board). These entities are actively engaged in approving and monitoring the Department's financial management reform efforts.

The DoD Financial Management Steering Committee oversees the development of the functional requirements for general fund financial and accounting systems, facilitates the implementation of policy recommendations, and addresses financial management systems and practices. The Committee is chaired by the USD(C) and includes:

- the DFAS Director
 - Assistant Secretaries (Financial Management and Comptroller) of the three Military Departments
 - Comptroller of the Defense Logistics Agency
 - a senior official from the Office of the Assistant Secretary of Defense
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(Command, Control, Communications, and Information) (ASD (C3I))

The Policy Board monitors the implementation and operation of the working capital funds, including policies, rates, cash flow analysis, and the criteria for inclusion of business areas therein. The Policy Board is chaired by the USD(C) and includes the Assistant Secretaries (Financial Management and Comptroller) of the three Military Departments and:

- representatives from the Joint Chiefs of Staff
- the USD (Personnel & Readiness)
- the ASD (C3I)
- the Director of the DFAS

The DoDIG is a special observer to the Policy Board. Overarching policies, procedures and reporting guidance for working capital fund activities were formally incorporated into the DoD FMR and published in December 1994. Three sub-committees, Oversight of Policy Actions, Cost Reductions, and Performance Review, were established to develop recommendations and to review recommendations submitted to the Policy Board.

The Army General and Mission Equipment Working Group – CFO Compliance is a joint working group that includes key Army and DFAS representation. This group works to ensure successful and accurate reporting of general and mission equipment in the Army. It is determining key elements, possible approaches, and solutions for meeting existing and future reporting requirements for Army equipment, as well as changes in systems to meet equipment-reporting requirements.

The Senior Level Steering Group (SLSG) was created in FY 1993 as a direct result of the internal audits of the Army's financial statements prepared under the CFO Act. It is composed of the principal deputies of the Army Staff and Secretariat. The Group's mission is to address issues raised by the auditors and develop approaches to meet the requirements of the CFO Act. In addition, the Group's responsibilities have been expanded in recent years to include acting as the Secretary of the Army's corporate review board for the annual statement of assurance on management controls, and for the review of selected and potential Army-level material weaknesses.

The Real Property Integrated Process Team (RP-IPT)-CFO Compliance is a joint working group that includes key Army and DFAS representation to assist in ensuring the successful and accurate reporting of land, buildings, and structures. The RP-IPT determines approaches and solutions for meeting existing and future reporting requirements for the Army's real property. Specific issues addressed by the RP-IPT include:

- overall issues of accounting for and reporting of the Army's investment in land, buildings, and structures
- determining how to apply definitions for Stewardship Reporting
- identifying data sources to quantify and value the Army's investment in land, buildings, and structures

The team is currently in the process of determining and implementing changes needed to existing systems to meet the reporting requirements for real property.

FINANCIAL MANAGEMENT STRUCTURE

Operational Structure

The Department's current finance and accounting structure is split between the Military Departments and the Defense Agencies, and the Department's primary financial accounting organization, the DFAS. The primary or source level financial management data originates with the Military Departments and the Defense Agencies. This data is then fed to the DFAS where the data is processed in the Department's finance and accounting systems.

As the Department's financial management service organization, the DFAS processes transactions and prepares the financial statements and reports. The DFAS charges each Military Department and Defense Agency a fee for its services.

The Military Departments and the Defense Agencies are responsible for providing the DFAS with source finance and accounting data. Operational commanders and program managers acquiring, managing, allocating, transporting, using, or disposing of DoD resources generate this source data, called program events. The Military Departments and the Defense Agencies own and operate the program feeder systems that feed program event data to the DFAS. The DFAS then processes the data and provides commanders and managers, at all levels, the financial information needed to make financial decisions, meet reporting requirements, and maintain the general ledger.

DFAS Functions

The DFAS is organized to perform the Department's basic finance and accounting operations. Finance operations include the processing of payments to DoD personnel, retirees, annuitants, and contractors. Accounting operations include recording, reporting, and analyzing financial activity.

Finance Functions

Currently, the DFAS performs the following nine financial activities, primarily focusing upon payment operations.

Military Pay is the payment of uniformed men and women.

Retiree and Annuitant Pay is the payment of military retirees and dependents.

Civilian Pay is the payment of DoD civilian employees.

Vendor Pay is the payment of commercial invoices, except for centrally managed contracts.

Travel Pay is the payment for official duty travel.

Debt Management is the collection of debts from individuals and contractors.

Disbursing releases monies for various types of functions.

Contract Pay is the payment to DoD contractors for goods or services rendered

against centrally managed contracts.

Transportation Pay is the payment for government bills of lading and transportation requests.

Accounting Functions

Accounting functions currently consist of six activities.

Working Capital Fund activities operating in a business-like environment where the customer requiring the support pays for services or products on a unit-cost basis.

General Fund supports the management of funds appropriated by the Congress to perform the Department's missions.

Cash Accountability records, manages, and reports DoD expenditures to the Department of the U.S. Treasury. Accounting, pay, and disbursing systems update cash accountability information.

Departmental Reporting consolidates budget execution, expenditure, and general ledger information from the Defense Working Capital Fund and General Fund accounting systems to produce fiduciary and managerial reports for the U.S. Treasury, the OSD, the OMB, the Military Departments, the Defense Agencies, and other federal agencies.

Foreign Military Sales provide accounting support to activities that sell military equipment, weapons, technology, and training to foreign governments based on agreements with the United States.

Non-Appropriated Funds support revenue-generating morale and welfare activities for the Military Departments and the Defense Agencies, such as officer and enlisted clubs, hobby shops, child care centers, libraries, gyms, and billeting funds. These activities operate like a private-sector business and are supported by user fees.

The Military Departments and the Defense Agencies

With the establishment of the DFAS as the Department's financial service organization, the Military Departments and the Defense Agencies generally no longer perform core finance and accounting functions at the installation and agency level. However, the Military Departments and the Defense Agencies did retain managerial accounting responsibilities to provide oversight, validation, and review of the following functions to support the activity commanders, agency directors, and the DFAS operating locations (OPLOCs).

- Reviewing and computing travel claims prior to forwarding them to the operating locations.
- Assisting the OPLOCs with follow-up on problem transactions.
- Distributing funds.
- Providing data electronically and forwarding documents to the OPLOCs.
- Preparing and processing collection vouchers for checks and cash received locally.

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| <ul style="list-style-type: none"> • Reconciling funding document differences. • Printing hard copy reports as required. • Processing receiving reports. • Approving travel obligations. • Providing military pay customer service. • Providing cash support for contingency operations. | <ul style="list-style-type: none"> • Inputting civilian and military pay transactions. • Interpreting accounting reports for the installation. • Monitoring legal limitations • Inputting accounting transactions (i.e., commitments, earnings, funds, inventory transfers, real property transfers, and obligations). |
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Technical Supporting Structure

The DFAS maintains the core systems required for finance and accounting. Each of the five DFAS centers is responsible for supporting certain functions and the systems required to support those functions. Multiple systems are used to perform the majority of finance and accounting functions, although some functions are performed from one system. For example, the vendor pay function is performed at multiple DFAS locations using multiple Military Department-specific systems, while DFAS-Cleveland performs the retired pay function and uses one system to support this function.

The Military Departments and the Defense Agencies maintain program systems to support their respective missions, although not all program systems contain source-level financial management information. Program systems that contain information necessary for financial management are considered program feeder systems. These program feeder systems send finance and accounting information to DFAS systems through real-time, electronic, or manual interfacing.

The Department is currently employing technological improvements, which include some EC/EDI. For example, the DFAS has implemented a web invoicing system that enables a vendor to enter invoices into templates on a DFAS owned Web server that processes and routes the invoices to the appropriate payment system. The vendor gains all the benefits of submitting their invoices electronically, but eliminates the normal telecommunications costs associated with EDI. The benefit of using EDI is one-time data entry, which minimizes the opportunity for data error. The benefit of EC is that it provides prompt payment to vendors and reduces the amount of paper used. Organizations throughout the Department are in different stages of implementation of EC/EDI.

The Department is also using EFT. Currently, over 90 percent of DoD civilian employees and military personnel have their pay directly deposited into their accounts through EFT. The DFAS is also implementing EFT in its vendor pay systems. Vendors can receive payment of funds electronically by registering their financial institution account information with the DFAS.

FINANCIAL MANAGEMENT STATUS

Scope

Financial management in the Department is a work-in-progress designed to fulfill the needs of its leaders, meet statutory requirements, maximize efficiency and minimize fraud. There have been notable successes but progress is slow in some areas. It is impossible to reverse decades-old problems overnight, and some reforms will require several years to implement.

This section provides a status of the progress the Department has made toward developing the effective financial management that will result in auditable financial statements. It discusses the progress made toward the long-term solution of the integrated financial management system identified in the Concept and includes a discussion of impediments to auditable financial statements and actions being taken to remove these impediments.

The current status of the Department's financial management is discussed in five areas:

- finance and accounting systems
 - critical feeder systems
 - policy and oversight
 - infrastructure
 - implementation strategies
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Finance and Accounting Systems

Automated finance and accounting systems are the foundation, the essential tools, of the financial management process. They provide the "raw material" for fiduciary accounting, analysis, and decision making. The Department identified 98 systems as its FY 1999 baseline of current finance and accounting systems. The Department is in the process of evaluating the systems for compliance with Federal financial management systems requirements and accounting standards.

Of the 98 finance and accounting systems, 8 systems have been determined to be substantially compliant, 9 systems are partially compliant, 10 system's compliance status has not been determined, and 5 systems are non-compliant. There are 66 legacy finance and accounting systems scheduled for either elimination or replacement and resources will not be allocated to make them compliant.

Critical Feeder Systems

Achieving accurate and acceptable financial management reports requires enormous efforts from all functional communities within the Department, not just the financial management community. Much of the data needed for sound financial management information comes from systems operated by other functional communities. These systems, such as, logistics, acquisition, personnel, and medical are owned by their respective functional communities. Therefore, much of the effort involves working with those communities to upgrade their systems to improve their data integrity, internal controls and interfaces with the Department's financial management systems.

In FY 1999 the Department identified a baseline of 70 critical feeder systems and is in the process of evaluating these systems for compliance with Federal financial management systems requirements and accounting standards.

Of the 70 critical feeder systems, 15 have been determined to be substantially compliant, 3 partially compliant, 4 non-compliant, and 13 system's compliance status has not been evaluated. There are 35 legacy critical feeder systems scheduled for either elimination or replacement and resources will not be allocated to make them compliant.

Policy and Oversight

Sound financial management is important to the Department for three main reasons: (1) providing cost visibility, (2) ensuring funds are expended for their intended purpose, and (3) providing dependable financial operations support for our troops.

In pursuit of sound financial management, the Department has promulgated more stringent and responsible guidance in a number of financial management areas. Such policies include, but are not limited to:

- establishing obligations for unmatched disbursements, negative unliquidated obligations, and in-transit disbursements
- recording obligations in the official accounting systems within 10 days of occurrence
- establishing responsibilities and requirements for reconciling contract payments
- reviewing and validating obligations at least three times annually
- ceasing payments should accounts go in the red
- implementing the United States General Ledger structure
- pre-validating payments at levels below those required by statute
- establishing rules and responsibilities for the DFAS and the Military Departments and Defense Agencies for the preparation of various financial reports

Another area under policy and oversight the Department has strengthened is

managerial internal controls. The Department implemented checks, balances, and approval requirements for transactions that affect resources. Internal controls minimize the Department's susceptibility to fraud, waste, abuse, and mismanagement within its finance and accounting operations. The Department strives to incorporate the appropriate levels of verification without requiring excessive resources or hampering the ability to complete the mission. Over the past 12 months, the Department has taken significant actions to improve internal controls to include:

- enacting 100 percent review of the Department's vendor pay systems to determine who has access and at what levels, ensuring the necessary separation of duties
- strengthening in-house reviews to detect improper alterations of receiving reports
- enhancing fraud awareness and prevention training for vendor pay employees

Infrastructure A supporting infrastructure is essential for achieving the integrated financial management system. The infrastructure provides the environment in which efficient and effective financial management operations may be conducted.

The DFAS is establishing the DCII to support the use of common data elements for the collection, storage, and retrieval of finance and accounting data; support the use of common transactions; and support of the movement of common transactions and data among systems. This reform is an ambitious effort to standardize and electronically share acquisition data among the acquisition and financial management communities. This effort will greatly improve the interactions between DoD procurement systems and the financial systems that process and account for the payments of the Department's acquisitions.

Capable and competent personnel are vital to the efficient and effective operations of the Department's financial management. Comptrollers, deputy comptrollers, budget officers at the Military Departments and the Defense Agencies, and managers of finance and accounting operations at the DFAS are key DoD financial managers. The Department is developing professional standards for its financial managers. Such standards include recommended education and training requirements, participation in continuing professional education programs, and perhaps some form of professional certification. The Department's goal is to ensure that as individuals are promoted, they attain and exceed desired core competencies in financial management.

Two other important aspects of a reliable financial management system are computer security and internal controls. The Department experiences an

estimated 250,000 computer attacks by computer hackers yearly. DoD computer controls need to provide adequate protection against these attacks for significant financial functions such as payroll, personnel, disbursements, and inventory. In response, the Department continues to enhance its computer security. Systems errors can be fatal to a complex computer system, and the Y2K problem is an issue for all computer systems.

The DFAS has worked hard to ensure that all systems are Y2K compliant. The overall goal has been to provide a coordinated effort that ensures no DoD financial management system is adversely affected by Y2K problems. Consolidation of the Department's finance and accounting systems has substantially reduced the cost of fixing the Y2K problem. The DFAS is on track to complete all Y2K-related programming for its finance and accounting systems, including the platforms, or hardware, on which these applications operate, and is expected to be fully Y2K compliant by the end of FY 1999. The financial management community also is working diligently with the other functional communities to ensure incoming data streams are compliant as well.

**Short Term
Implementation
Strategies**

On May 26, 1998, the President called for an unqualified audit opinion on the government-wide financial statement for FY 1999. In order to meet this requirement, the Department must improve many aspects of its financial management. While the system changes discussed throughout the Plan are a long-term solution, the Department is formulating interim strategies to achieve a satisfactory level of compliance in its major accounts and attain more favorable audit opinions on financial statements.

To succeed in this effort, the Department has fully engaged in a partnership with the OMB, the GAO, and the Department of Defense Office of the Inspector General (DoDIG) of the Department of Defense. Impediments to receiving favorable audit opinions have been identified. Methodologies to deal with these impediments have been developed and coordinated with the OMB, the GAO, and the DoDIG. To implement these alternatives, plans detailing short-term strategies for solutions to the impediments have been developed along with the identification of responsible parties and milestone dates needed to support accomplishment of the Department's goal. To ensure the Department stays on track, applicable organizations are being asked to report on their progress and update these plans as needed.

The implementation strategies to achieve auditable financial statements are focused on correcting deficiencies in the following areas:

- inventory
- PP&E
- future liabilities

- U.S. Treasury fund balances
- intragovernmental eliminations

Inventory

The inventory problems facing the Department include the following:

- existence, completeness, and valuation of inventory
- operating material and supplies

An important part of the Department's financial management operations is the ability to consistently value and reconcile inventory to financial account balances. Current accounting standards require the Department to report inventory at historical cost or at latest acquisition cost if adjusted by an allowance for unrealized gains and losses to approximate historical cost. The Department's inventory systems do neither. Instead, the Department's inventory systems value assets at standard (selling) price. Additionally, inventory values are not included in DoD financial systems, but in logistical inventory systems. As a consequence, the dollar value of inventory reported on financial statements is a calculated amount, not a system-driven amount. These calculated amounts are determined using a computational formula that adjusts logistical inventory values to an approximation of historical cost and latest acquisition cost.

The Department is actively pursuing immediate improvements in the control of inventory. In order to improve the accuracy of inventory amounts reported in its financial statements, the Department is taking the actions listed below:

- Identifying systemic errors in inventory transaction processing (issues and receipts) and the need for routine manual adjustments, determining the sources and causes of those errors and adjustments, and developing a remedial plan to correct such errors and eliminating the need for adjustments.
- Improving controls over physical inventories by establishing physical inventory plans and procedures for statistical sampling; ensuring personnel who perform physical inventory counts do not have physical control over inventory; implementing risk and sensitivity-based count and control procedures; and reconciling physical and financial records promptly.
- Improving control over intransit inventory by implementing procedures to ensure that receipts and issues are properly and promptly posted to appropriate records.
- Improving the accuracy of the valuation of inventory by approximating the historical cost for the beginning inventory balance, continuing to use formulas to approximate historical cost where inventory is controlled through systems that do not report historical cost, and working towards a

consensus on the accounting treatment of inventory gain and loss accounts, the valuation of reparable items, and revenue from sales of reparable items.

PP&E

The Department faces several impediments in achieving an unqualified opinion on annual financial statements because of problems with PP&E. These impediments include the following:

- existence and completeness
- valuation of general PP&E
- Government property in the hands of contractors
- deferred maintenance

The accounting standard for the recording of General PP&E requires that (1) it be recorded at historical cost and depreciated, (2) costs necessary to bring the assets into a fully operational condition be included in the recorded cost, and (3) when the historical cost of existing general PP&E assets is not available, estimates are to be used. The Department's property accountability systems were not designed to capture, retain, and depreciate the costs of PP&E assets.

Under the OMB agreed upon implementation strategy, the Department has directed that unless a Military Department or Defense Agency has a fully operational property accountability system that meets CFO requirements (to include the capability to capture and maintain historical cost data and calculate depreciation), they must expedite the implementation of a CFO compliant property system for its General PP&E assets prior to the end of FY 1999.

Beginning in FY 1999, newly acquired General PP&E assets are capitalized at acquisition cost, and the supporting documentation retained in accordance with appropriate regulations. For General PP&E assets acquired prior to FY 1999, the Department is working with the auditors, and have hired private accounting firms to develop an acceptable method for establishing a value where adequate documentation does not exist.

An Exposure Draft amending the Statement of Federal Financial Accounting Standards (SFFAS) No. 6 and No. 8, requires the reporting of quantities, condition, and funding trends of National Defense PP&E (e.g. weapons systems). Information concerning quantities and condition of National Defense PP&E is not maintained in financial systems but in logistical systems. Though difficult to obtain, this information is available.

The Department has approximately \$92 billion in government furnished property and material in the possession of contractors. The Federal Acquisition Regulation (FAR) requires contractors to maintain records for all government furnished property (GFP) in their possession and property acquired by contractors for the Department, and to provide this information to the

Department. The FAR also precludes Federal agencies from keeping duplicate records; therefore, the Department has historically relied on the contractors for providing this information. However, the OUSD(A&T) is issuing a new property accountability regulation that requires the Military Departments and the Defense Agencies to maintain GFP information in DoD property systems and is modifying the Defense Federal Acquisition Regulation Supplement (DFARS) to incorporate new contractor reporting requirements that will meet financial statement reporting requirements.

The Department recognizes that its PP&E accountability and control systems are not 100 percent accurate. However, the errors that typically are identified relate to assets that have been disposed of or are not in active use. The OUSD(A&T) has issued several memorandums to the Military Departments and Defense Agencies stressing the need for complying with existing PP&E accountability policies to ensure consistency, completeness, and reliability of the data.

The cost of deferred maintenance for PP&E must be reported in Required Supplemental Information to the annual financial statements. The Department does not have automated systems to capture and report deferred maintenance estimates that can be tied back to specific PP&E assets such as aircraft, tanks, and ships. In accordance with the OMB approved implementation strategy, the Department will include in its FY 99 financial statements the deferred maintenance amounts reported by the Military Departments and the Defense Agencies that are developed as part of the Department's budget process for both general PP&E real property and National Defense PP&E assets. In addition, the FASAB and the OMB recognize that additional guidance needs to be developed for consistent and adequate government-wide disclosure of deferred maintenance amounts; therefore, the Department has volunteered to lead a government-wide task force to develop additional guidance and standard definitions, methodologies for determining maintenance requirements, and reporting guidelines.

Future Liabilities

The Departments of the Army and Navy, as well as most Defense Agencies, have selected the Defense Property Accountability System (DPAS) for General PP&E personal property accountability and for financial reporting purposes, and are presently in the process of deploying or migrating to DPAS. The DPAS will provide accountability control over personal property, serve as the personal property subsidiary ledger and will replace over 100 separate systems. The Department faces several impediments to auditable financial statements because some of the Department's future liabilities have not been accurately assessed. These liabilities include:

- restoration
- hazardous waste

- disposal
- post-retirement health care

Determining the future cost of liabilities through the use of current costs instead of budget obligations and including all potential liabilities in the calculation, are necessary to provide accurate estimates. The Department is establishing policy and procedures to estimate the expected disposal costs for major weapons systems such as aircraft, missiles, ships, submarines, and ammunition. The DoD FMR is being revised to incorporate specific guidance that clearly identifies the requirement for managers, at all levels, to recognize estimated environmental liabilities.

In reporting the actuarial liability for military post-retirement health benefits and claims, historically the Department based these claims on funds that were obligated. The Department recognizes deficiencies in the reporting of the actuarial liability for military post-retirement health benefits and claims. The Department is revising its procedures to ensure that all data used in calculating the Military Retirement Health Benefits Liability is current and complete and that accurate, reliable, and complete data required to estimate post-retirement health care liabilities is captured and reported.

Progress payments are required to be recorded as assets for construction in progress. Any unpaid contractor costs, referred to as contract holdbacks, are to be recorded as liabilities. The audit community has indicated that the Department should treat all financing payments, not just those based on the percentage of completion, as construction in progress and record liabilities. However, progress payments based upon percentage of completion represent only one type of contract financing payment the Department is authorized to make. Other financing payments are also used as a means of providing contractors financing prior to the delivery of goods under fixed-price contracts. For most fixed-price contracts, for which financing payments are issued, the Department becomes liable only when goods are delivered in conformance with the contract terms. The Department is not liable for costs that the contractor has incurred at the time financing payments are issued.

U.S. Treasury Fund Balances The Department faces impediments to auditable financial statements because of problems with its U.S. Treasury fund balances.

Appropriation cash balances on the books of the U.S. Treasury must reconcile with appropriation cash balances on the Department's books. For all appropriations, the DFAS Cleveland, Denver, and Indianapolis Centers electronically transmit monthly collection and disbursement data to the U.S. Treasury. In addition, other agencies that collect and disburse funds for the Department also report these amounts to the U.S. Treasury. The U.S. Treasury provides the Department with monthly and annual reports that show the U.S.

Treasury's fund balance with the U.S. Treasury account balance, which is the net amount. In the past, the Department reported the amounts from the U.S. Treasury instead of the balance reflected in the Department's financial records on its financial statements. Frequently, the account balances at the U.S. Treasury do not agree with the account balances on the Department's financial records. These differences are caused primarily by three items: (1) separate accounting and reporting systems, (2) errors in the preparation and perpetuation of financial information, and (3) the DoD collection and payment process.

As approved by the OMB, the Department will discontinue reporting the cash balances reported by the Treasury and, instead, report the fund balance shown in the Department's "Fund Balance With Treasury" general ledger account at the appropriation level, as may be adjusted for appropriate changes. Any differences between the amount reported by the Department and the balance in Treasury's accounts will be explained in footnotes to the financial statements. (Normally, such differences are the result of intransit disbursements, collections, and funding adjustments reported to the Treasury by other agencies but not yet reported to the DFAS Centers.)

The Department will continue its efforts to minimize the use of suspense accounts, ensure the supportability of suspense account balances, and ensure charges/collections to suspense accounts are being reversed and posted to the correct accounts in a timely manner.

Cash balances on the financial records of the Department's installations must reconcile with the summary cash balances on the financial records of the headquarters. Fund balances for appropriations and changes thereto, along with the corresponding U.S. Treasury accounts, are maintained in the financial records of installations and headquarters. The headquarters fund balance is a summary of the various installations. The installation financial data is summarized monthly and forwarded to the headquarters level for financial reporting. Monthly reconciliations between the installation maintained accounts and the headquarters level accounts should be performed but are not always reconciled. When performed, the installation fund balances do not always agree with the account balances at the headquarters level. Therefore, the balance on the monthly financial statements is not fully supported by the detailed financial records. The imbalances are primarily caused by three reasons: (1) the variety of non-integrated databases in use preclude the easy and reliable integration or interfacing of information from other financial systems; (2) the process of transferring documents among the various financial activities creates problems such as timing differences in posting transactions to the DoD financial records as well as misplaced documents; and (3) errors in the preparation and perpetuation of financial information.

The Department has directed disbursing officers to comply with existing policy guidance and prepare a monthly transaction-level reconciliation between disbursement and collection activity reported to the Treasury, via the DFAS Centers. The Department will require each disbursing station to institute controls over the reconciliation process.

To improve this process in the long-term, the Department plans to better integrate disbursing and accounting systems and require periodic reconciliations of the installation-level and headquarters-level funds with the U.S. Treasury account balances. The gradual lowering of the prevalidation limit reduced the level of differences in cash balances between Department headquarters and the installations. Continual lowering of the prevalidation limit and its expansion to all disbursing stations will enhance its effectiveness.

Intra-
governmental
Eliminations

The Department faces impediments to auditable financial statements because of problems with its intragovernmental eliminations. Federal agencies may be required to verify the reported reconciliation of elimination amounts between agencies. Currently, there is no guidance concerning this issue.

In reporting accounts payable, expenses, and disbursements from other federal agencies, there are no standard Federal Government-wide policies, procedures, or processes. As a result, the Department does not routinely receive accrual data prior to the receipt of goods or services. The Department's accounting systems were not designed to aggregate accounts payable and expense data for individual providers of the goods and services.

The Department's short-term strategy to improve intra-governmental eliminations includes requiring the Military Departments and the Defense Agencies to identify major trading partners that make up the bulk of interagency transaction balances. As part of the Department's longer term efforts to improve financial processes and systems, the Department will continue to work to better identify both the buying and selling parties of each intra-governmental transaction at the transactions level and use this information to: generate eliminating entries and/or conduct required reconciliations.

REMEDATION PLAN ANALYSIS

Background The FFMIA of 1996 requires each Federal agency implement and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable federal accounting standards, and the U.S. SGL at the transaction level.

The FFMIA requires that the head of the agency determine whether the financial management systems of the agency comply with the requirements discussed above. Such determination shall be based on a review of the report on the agency-wide audited financial statement, and any other information the head of the agency considers relevant and appropriate.

If the head of the agency determines that the agency's financial management systems do not comply with the requirements of the FFMIA, the head of the agency, in consultation with the OMB Director, shall establish a remediation plan. This plan shall include resources, remedies, and intermediate target dates necessary to bring the agency's financial management systems into substantial compliance. The remediation plan shall bring the agency's financial management systems into substantial compliance no later than three years after the date a determination is made that the agency's financial management systems are not in compliance. This occurs unless the head of the agency with concurrence of the OMB Director:

- determines that the agency's financial management systems cannot comply with the requirements
- specifies the most feasible date for bringing the agency's financial management system into compliance with the requirements
- designates an official of the agency who shall be responsible for bringing the agency's financial management systems into compliance with the requirements by the date specified

Remediation Plan Discussion The Department has determined that its financial management systems are not in compliance with the FFMIA's stated requirements. To bring its financial management systems into substantial compliance, the Department is using the resources, remedies, and intermediate target dates described in this Plan.

Resources The Department is committed to bringing its financial management systems into compliance with the requirements of the FFMIA. Volume II of this Plan details the corrective actions, milestones, and resources necessary to achieve substantial compliance for the finance, accounting, and critical feeder systems.

Achieving The Department is implementing a long-term strategy to bring its financial

Substantial Compliance management systems into compliance with the FFMIA requirements and achieve an integrated financial management system. The objectives under this strategy are to:

- ensure finance and accounting and critical feeder systems comply with statutory, regulatory and audit requirements
- eliminate unnecessary systems and consolidate finance and accounting functions to a select set of migration systems
- employ technology improvements to develop standard systems that use logically integrated or interfaced databases with flexible infrastructure supporting future changes
- implement a “single entry” structure

Intermediate Target Dates Some of the major intermediate target dates toward achieving substantial financial management system compliance include:

Objective	Target Date
Completion of the consolidation of operating locations into the DFAS	September 1998
Evaluations of all finance, accounting, and critical feeder systems	March 31, 2000
Completion of the reduction of total finance and accounting systems from 334 to 37	FY 2003
Elimination of system deficiencies	To Be Determined* (TBD)
Validation of substantial system compliance for systems	TBD*
Achieve substantial compliance with finance and accounting systems	TBD*
Achieve substantial compliance with critical feeder systems	TBD*

***Note:** Dates for achieving system compliance will be established after the system evaluations are completed (March 31, 2000).

Summary The Department has determined that its financial management systems do not comply with the requirements set forth by the FFMIA. To attain substantially compliant systems, the Department is implementing a long-term strategy. The steps for achieving substantial compliance for each system are discussed in the Transition Plan, and the details are incorporated in Volume II.

SUMMARY OF CURRENT DOD FINANCIAL MANAGEMENT

Scope During 1998, the Department took a comprehensive look at its financial management operations and for the first time, articulated its concept for future operations. During 1999, the target architecture was expanded on as an integrated financial management system for which the Department established a baseline of finance, accounting, and critical feeder systems.

Current Assessment Financial Management in the Department is a work-in-progress designed to fulfill the needs of its leaders, meet the statutory requirements, maximize efficiency and minimize fraud. There have been notable successes, but progress is slow in some areas. It is impossible to reverse decades old problems overnight and some reforms will require several years.

The Department is in the midst of the most comprehensive reform of financial management systems and practices in its history. Financial operations have been consolidated, the number of noncompliant finance and accounting systems have been significantly reduced, standard systems have been designated, ambitious deployment schedules have been established and implemented, and business practices have been reengineered to adopt best practices from both private and government sectors.

The Department's current leadership is committed to making financial management reform a hallmark of its stewardship. Progress to date has been substantial and the Department is determined to successfully complete this significant reform effort.

Transition to the Future Environment In moving forward, the Department's financial management reform must accommodate three unavoidable constraints. First, the Department cannot stop its financial operations while it fixes outdated business practices and flawed systems. Every day the Department must manage payrolls, pay contractors, and produce financial reports. These daily operating requirements impose a strong practical constraint on the Department's plans for improving systems and business practices.

Second, lasting reform demands consensus and collaboration. Few solutions rest exclusively within the jurisdiction of the financial management community. The development of an infrastructure capable of providing more accurate and reliable information and achieving auditable financial statements is a high priority within the Department.

Third, legislation in the 1990's has changed the Federal Government's accounting requirements. More recent legislation requires audited financial statements from federal agencies. This requires the Department to track financial data on items from their purchase to disposal in a more integrated process. No longer can the Department rely solely on separate systems monitoring separate categories.

The Department envisions an aggressive future environment for its financial management that involves implementing integrated systems, single transaction-driven general ledger data entry, and real-time data access. As the Department's business areas are widely diverse and complex and were not created to adapt easily to the envisioned environment, and considering the overall size of the Department and its activities, change of this magnitude poses a monumental challenge.

Ultimately, the Department intends to achieve sound financial management through financial management reform. An integrated financial management system is the basis for efficient and effective operations from which sound financial management decisions are made. To move from the current environment to the integrated financial management system, the Department is taking a two-track approach. This entails both short-term and long-term strategies, outlined in the following Transition Plan. As a result of these strategies and accompanying initiatives, the Department expects to make substantial progress each year.
